BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	**FORMAL OPINION**
	)	
	)	**2007-SBE-003**
	)	
PAUL L. MICKELSEN AND	)	Case No. 343108
	)	
PATRICIA MICKELSEN	)	
	)	

Representing the Parties:

For Appellants: Sharyn M. Fisk

For Franchise Tax Board: Jozel Brunett, Tax Counsel

Counsel for the Board of Equalization: Ian C. Foster, Tax Counsel

I. Introduction

This appeal is made pursuant to section 19324 of the Revenue and Taxation Code[1] from the action of the Franchise Tax Board ("FTB" or "respondent") in denying appellants' claim for refund of $537,178 for 1999. The entire amount of the claimed refund represents interest that had accrued and was paid on appellants' 1999 income tax liability, and the issue presented in this appeal is whether appellants are entitled to interest suspension under section 19116. For the reasons set forth in this opinion, we conclude that appellants are not entitled to interest suspension under section 19116.

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[1] Unless otherwise specified, all references to a "section" or "sections" are to sections of the Revenue and Taxation Code.

II. The Voluntary Compliance Initiative

This appeal arises out of appellants' participation in California's Voluntary Compliance Initiative ("VCI"). In order to properly set the stage for our discussion in this appeal, we believe it is helpful to begin with a brief discussion of the background and nature of the VCI.

The California Legislature enacted the VCI in 2003, giving taxpayers the opportunity to file amended returns, disclose potentially abusive tax shelter transactions, pay the resulting tax and interest, and avoid the application of penalties. (Rev. & Tax. Code, § 19751 et seq.) Taxpayers could file amended VCI returns during the period from January 1, 2004, through April 15, 2004, inclusive. (Rev. & Tax. Code, § 19751, subd. (b).)

Taxpayers who participated in the VCI could elect either of two options. Under the first VCI option, the state would waive all penalties attributable to the abusive transactions (Rev. & Tax. Code, § 19752, subd. (a)(1)); the taxpayer would be immune to criminal prosecution in connection with the abusive transactions (*Id.*, subd. (a)(2)); and, the taxpayer would give up the right to "file a claim for refund for the amounts paid in connection with" the abusive transactions. (*Id.*, subd. (a)(4).) Under the second VCI option, the state would waive all penalties attributable to the abusive transactions except the accuracy-related penalty (*Id.*, subd. (b)(1)); the taxpayer would be immune to criminal prosecution in connection with the abusive transactions (*Id.*, subd. (b)(2)); and, the taxpayer would retain the right to file a claim for refund. (*Id.*, subd. (b)(4).)

We have recently held that we lack jurisdiction to hear and decide an appeal from respondent's denial of a claim for refund for amounts paid (including interest paid) in connection with a taxpayer's participation in VCI option one. (*Appeal of Benjamin and Carmela Du*, 2007-SBE-001, July 17, 2007.) There is no such blanket limitation on our jurisdiction with regard to taxpayers who elected VCI option two, as those taxpayers retained their right to file refund claims. The instant appeal arises from appellants' participation in VCI option two.

III. Factual and Procedural Background

Appellants filed their original 1999 return on April 11, 2000, reporting taxable income of $1,434,191 and self assessing a total tax liability of $129,996. On April 1, 2003, respondent notified appellants that it had selected their 1999 return for an audit that would focus on potentially abusive tax

shelter issues. The parties agreed to defer the audit pending the outcome of a federal audit on similar issues.

Respondent invited appellants to participate in the VCI by letter dated December 3, 2003. On April 2, 2004, appellants filed an amended VCI return for 1999 and elected VCI option two. On their amended VCI return, appellants reported their income without regard to the potentially abusive tax shelter transactions, reported taxable income of $31,307,290, and self assessed additional tax of $2,778,198. With the amended return, appellants remitted most of the amount needed to satisfy the balance of tax and interest and, by April 15, 2004, appellants remitted the remainder.

On March 15, 2005, appellants filed a second amended return for 1999, claiming a refund in the amount of $692,196. The refund claim had two bases: first, it reflected a settlement agreement with the Internal Revenue Service ("IRS") that reduced appellants' taxable income by $1,666,863;[2] second, it reflected the suspension of interest from October 15, 2001 (18 months from the due date of the original return), through April 2, 2004 (the filing date of the VCI return). Appellants argued in their claim that interest suspension was required under section 19116. Respondent allowed the portion of the claim that was attributable to the settlement with the IRS, but denied the portion attributable to interest suspension. This appeal followed.[3]

IV. Applicable Law

A. The Imposition and Accrual of Interest

California law imposes interest from the date on which any personal or corporate income tax is due until the date the entire balance is paid in full. (Rev. & Tax. Code, § 19101, subd. (a).) Interest is paid, assessed, and collected in the same manner as the underlying tax. (*Id.*, subd. (c).) This Board has long recognized that the assessment of interest on any unpaid tax is mandatory. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) We have also recognized that interest is not a penalty, but is simply compensation to the state for the lost time-value of money received after the due date.

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[2] The federal settlement resulted in a final federal determination on October 18, 2004.

[3] It appears there is no prepayment right to challenge respondent's decision not to suspend interest under section 19116. (See Rev. Proc. 2005-38 (2005-28 I.R.B. 81); *Goode v. Commissioner*, T.C. Memo 2006-48.) Our jurisdiction over this appeal is founded in appellant's claim for a refund of paid interest. (Rev. & Tax. Code, § 19322 et seq.)

(*Appeal of Alan F. and Rita K. Shugart*, 2005-SBE-001, July 1, 2005.) As such, the law provides no reasonable cause exception to the imposition of interest. (See *Id.*)

While there is no general reasonable cause exception to interest, the Legislature has enacted three provisions that provide limited relief from interest under specified circumstances. Section 19104, which we have discussed in detail in prior opinions, allows the FTB to abate interest to the extent that interest is attributable to an error or delay by an employee of the FTB "in performing a ministerial or managerial act." (Rev. & Tax. Code, § 19104, subd. (a); *Appeal of Ernest J. Teichert*, 99-SBE-006, Sept. 29, 1999; *Appeal of Michael and Sonia Kishner*, 99-SBE -007, Sept. 29, 1999; *Appeal of Alan F. and Rita K. Shugart, supra*.) Section 19112, which is rarely invoked before this Board, allows the FTB to waive interest when the taxpayer suffers an "extreme financial hardship caused by a significant disability or other catastrophic circumstance." The remaining statute, section 19116, requires the FTB to suspend the accrual of interest under specified circumstances. This appeal represents our first opportunity to address section 19116 in a published opinion.[4]

B. Section 19116 and Interest Suspension

Generally speaking, section 19116 gives respondent 18 months from the due date of a return to notify the taxpayer of an additional liability, during which time interest will accrue as usual. If respondent takes longer to provide notice of the liability, then the taxpayer will be relieved of some of the interest accrued after that 18-month period. Unlike sections 19104 and 19112, which give respondent the discretion to relieve taxpayers of interest, section 19116 is a mandatory provision; respondent must suspend the accrual of interest if the specified circumstances are present.

More specifically, section 19116 requires respondent to suspend the accrual of interest when respondent does not "provide a notice to the taxpayer specifically stating the taxpayer's liability and the basis of the liability" within a "notification period." (Rev. & Tax. Code, § 19116, subd. (a).) The "notification period" is the 18-month period following the later of (A) the date on which the taxpayer files a timely return, or (B) the original un-extended due date of the return. (*Id.*, subd. (b)(1).)

[4] Section 19116 applies to tax years ending after October 10, 1999. (Rev. & Tax. Code, § 19116, subd. (g); Ch. 931, Stats. 1999, § 18.) Section 19116 is patterned after Internal Revenue Code ("IRC") section 6404(g). (Pub. Law. 105-206, 112 Stat. 685, 743, § 3305.) While the two statutes are similar in concept, they differ in the details.

Interest suspension begins the day after the notification period ends, and interest accrual resumes 15 days after respondent mails the notice of liability. (*Id.*, subd. (b)(2).)

The notification period is extended in cases where the taxpayer is required by section 18622 to report federal adjustments to California.[5] If the taxpayer or the IRS notifies respondent of the federal adjustments within six months of the final federal determination the notification period ends one year after respondent receives such notice. (Rev. & Tax. Code, § 19116, subd. (e)(1)(A).) If the taxpayer or the IRS notifies respondent of the federal adjustments more than six months after the final federal determination, the notification period ends two years after respondent receives such notice. (*Id.*, subd. (e)(1)(B).) In such cases, interest suspension does not begin until after the end of the extended notification period. (*Id.*, subd. (e)(2).)

There are several instances in which section 19116 does not apply. For example, section 19116 does not apply to the late filing and late payment penalties. (Rev. & Tax. Code, § 19116, subds. (d)(1) & (d)(2).) Nor does section 19116 apply to any amount involving fraud. (*Id.*, subd. (d)(3).) One important exception deters abuse by prohibiting interest suspension on amounts that were self assessed on the taxpayer's original return. (*Id.*, subd. (d)(4).) As particularly relevant to this appeal, section 19116 does not apply to taxpayers with taxable incomes greater than $200,000 whom the FTB has contacted regarding the use of a potentially abusive tax shelter. (*Id.*, subd. (f).)

C. Revenue Ruling 2005-4 and FTB Notice 2005-4

Section 19116 and its federal counterpart, IRC section 6404(g), expressly require interest suspension when the government fails to notify the taxpayer of an additional liability within a specified time period. Those statutes do not, on their face, require interest suspension when the taxpayer notifies the government of an additional liability – that is, when the taxpayer files an amended return rather than waiting for notification from the government. Two administrative rulings have addressed the application of interest suspension to additional liabilities reported on amended returns.

In Revenue Ruling 2005-4 (2005-1 C.B. 366), the IRS posed the question of whether

[5] When federal adjustments result in an increase in California taxable income, the taxpayer must report those adjustments to California within six months of the final federal determination. (Rev. & Tax. Code, § 18622, subd. (a).) The date of the "final federal determination" is the date on which the federal adjustments are assessed for federal purposes. (*Id.*, subd. (d).)

interest suspension applies when a taxpayer reports additional tax on an amended return after having filed a timely return. In answering that question, the IRS first observed that the bar to suspending interest on self-assessed liabilities applies only to the original return, and not to liabilities shown on an amended return. The IRS next observed that a taxpayer who files an amended return and reports additional tax is aware of the liability and the basis therefor, which renders a notice by the IRS unnecessary. The IRS then concluded that interest suspension would apply to the additional tax reported on an amended return where: (1) the taxpayer had filed a timely original return, (2) the IRS did not notify the taxpayer of an additional liability within the notification period (i.e., 18 months from the original return), and (3) after the notification period, the taxpayer files an amended return reporting additional tax. The period of interest suspension would run from the end of the notification period to the date the amended return is filed (if the tax is paid with the amended return), or until 21 days after the amended return is filed (if the tax is not paid with the amended return).

In FTB Notice 2005-4, respondent announced that it would follow Revenue Ruling 2005-4 to the extent applicable under California law. Specifically, respondent stated that it would suspend interest on additional tax reported on amended returns where: (1) the taxpayer is an individual, (2) the taxpayer filed a timely original return for a tax year ending after October 10, 1999, and (3) the taxpayer filed an amended return increasing the taxpayer's liability more than 18 months after filing the original return. The period of interest suspension would run from the end of the notification period to 15 days after the amended return is filed. In order to give effect to the provisions of section 19116 that prohibited interest suspension in certain abusive tax shelter cases, FTB Notice 2005-4 stated that interest suspension would not apply to an amended return filed on or after January 1, 2004, where the taxpayer has a taxable income greater than $200,000 and FTB contacted the taxpayer about the use of a potentially abusive tax shelter.

The holding in Revenue Ruling 2005-4 has since been overturned by a statutory amendment. Effective December 21, 2005, Congress amended IRC section 6404(g)(1) so that the notification period begins after the taxpayer files an amended return. (Pub. Law. 109-135, 119 Stat. 2609, § 303(b)(2).) Thus, the interest accrued between the filing of the original return and the amended return is no longer suspended under federal law. California has not conformed to that change.

V. Discussion

Appellants contend that they are entitled to interest suspension under section 19116. Appellants point out that they filed a timely original return, that respondent never sent them a notice specifically stating a liability or the basis therefore, and, more than 18 months after filing their original return, appellants filed an amended return disclosing an additional tax liability. Citing Revenue Ruling 2005-4 and FTB Notice 2005-4, appellants maintain that they have satisfied the requirements for interest suspension with regard to the additional tax reported on their amended VCI return. Appellants therefore argue that the accrual of interest should be suspended from October 15, 2001 (18 months from the due date of the original return), through April 2, 2004 (the filing date of the amended VCI return).

Respondent contends that appellants are not entitled to interest suspension for two reasons. First, respondent argues that appellants filed their amended VCI return prior to the end of the "notification period," as that period was extended by subdivision (e) of 19116. Second, respondent argues that subdivision (f) of section 19116 and FTB Notice 2005-4 prohibit interest suspension in this case because appellants filed their amended VCI return after January 1, 2004, they have a taxable income greater than $200,000, and they were contacted by respondent about the use of a potentially abusive tax shelter.

After careful review of section 19116, Revenue Ruling 2005-4, and FTB Notice 2005-4, we conclude that appellants are not entitled to interest suspension on both grounds cited by respondent. Those grounds form two independent bases for our decision, which we will discuss separately.

A. Notification Period

Section 19116 expressly provides that the period of interest suspension begins after the "notification period" ends. (Rev. & Tax. Code, § 19116, subds. (b)(2) & (e)(2).) In the case of an amended return that reports additional tax, there can be no interest suspension unless, *inter alia*, the amended return is filed after the end of the notification period. (Rev. Rul. 2005-4; FTB Notice 2005-4.) Accordingly, in this appeal, we must determine whether appellants filed their amended VCI return after the end of the notification period.

Subdivision (b)(1) of section 19116 generally provides for a notification period ending 18 months from the due date of the original return. As appellants' original 1999 return was due on

April 15, 2000, the notification period in this case would have ended on October 15, 2001. Appellants filed their amended VCI return on April 2, 2004. Thus, they would be entitled to interest suspension if the general definition of the notification period in subdivision (b)(1) governs.

However, subdivision (e) of section 19116 extends the notification period when the taxpayer is required by section 18622 to report federal adjustments to California. In this appeal, there were federal adjustments that increased appellants' California taxable income and the date of the "final federal determination" was April 18, 2004. Appellants therefore were required to report the federal adjustments to California on or before October 18, 2004. (Rev. & Tax. Code, § 18622, subd. (a).) Because appellants reported the relevant federal adjustments prior to the six month deadline set forth in section 18622 (via their amended VCI return filed on April 2, 2004), the notification period was extended to one year after the date on which the adjustments were reported, or April 2, 2005. (Rev. & Tax. Code, § 19116, subd. (e)(1)(A).) Appellants filed their amended VCI return before the end of the notification period and, consequently, interest suspension is not allowed.[6]

Appellants dispute this analysis, arguing that subdivision (e) of section 19116 is not applicable for two reasons. First, they argue that subdivision (e) does not extend the notification period, but instead creates a "separate" or "new" notification period. Second, appellants argue that subdivision (e) does not apply because they reported the federal adjustments before those adjustments became final. We find both arguments unpersuasive.

Appellants argue that subdivision (b)(1) and subdivision (e) create separate notification periods. They assert that the notification period under subdivision (b)(1) ended on October 15, 2001, and the separate notification period under subdivision (e) did not begin until after they filed their amended VCI return. Under appellants' reasoning, they are entitled to interest suspension because they filed their VCI return after the end of the original notification period under subdivision (b)(1), and any separate notification period under subdivision (e) would be irrelevant. However, there is no indication in the statutory language that subdivision (e) creates a "separate" or "new" notification period. Instead,

[6] Revenue Ruling 2005-4 expressly held that, when the amended return is filed before the end of the notification period, interest suspension is not allowed. That holding is consistent with the unambiguous language of subdivision (b)(2) of section 19116, providing that the interest suspension period begins after the end of the notification period.

the language indicates just the opposite. Subdivision (b)(1), which defines the "notification period," begins with the statement "Except as provided in subdivision (e) …," indicating that when federal adjustments are involved, subdivision (e)'s definition is used instead of (not in addition to) subdivision (b)(1)'s definition. Subdivision (e) then begins with the statement: "The notification period under subdivision (a) shall be …." The use of the definite article "the" in that statement suggests the existence of one notification period. Consequently, the statutory language creates one notification period that is defined under either subdivision (b)(1) or subdivision (e), not two notification periods defined under both.

Next, appellants argue that subdivision (e) does not apply because they reported the federal adjustments before those adjustments became final. Appellants emphasize that they filed their amended VCI return 16 days before the date of the final federal determination. Appellants reason that, at the time they filed the amended VCI return, they were not yet required to report federal adjustments to California and subdivision (e) was not yet in play. We believe appellants have interpreted subdivision (e) too narrowly. Subdivision (e) plainly applies to ". . . taxpayers required by subdivision (a) of Section 18622 to report a [federal] change or correction . . . ." Subdivision (a) of section 18622 requires taxpayers to report federal changes to California when those federal changes increase California taxable income. In appellants' case, there were federal changes that increased California taxable income. Therefore, appellants were required by section 18622 to report federal changes to California and subdivision (e) extended the notification period in this case.[7]

B. Interest Suspension Related to Appellants' Amended VCI Return

Independent of our conclusion on the notification period, we also conclude that appellants are not entitled to interest suspension because they filed their amended VCI return after

[7] We also believe that appellants' narrow interpretation of subdivision (e) of section 19116 would open a clear avenue for abuse and could render subdivision (e) toothless. The obvious purpose of subdivision (e) is to ensure that the State is not denied interest because of a lengthy dispute at the federal level, over which respondent has no control. Because respondent cannot provide a notice of additional liability until federal adjustments become final, subdivision (e) gives respondent a reasonable period after being informed of the adjustments to issue its own notice. Under appellants' interpretation, a taxpayer who knows that federal adjustments are about to become final could report those adjustments to California a few days before the date of the "final federal determination," then claim that subdivision (e) does not extend the notification period. This would whipsaw the State of California, which could not send a notice of liability due to circumstances outside of its control, but which would then be forced to suspend interest anyway. Appellants' interpretation would thus make the application of subdivision (e) purely elective, which could not have been the intent of the Legislature.

January 1, 2004, they have a taxable income greater than $200,000, and they were contacted by respondent about the use of a potentially abusive tax shelter. This conclusion is compelled by the language of section 19116 and FTB Notice 2005-4.

At the heart of this issue is subdivision (f) of section 19116, which prohibits interest suspension in certain abusive tax shelter cases, along with language in FTB Notice 2005-4 that implements subdivision (f) in the context of amended returns. Before addressing the specific application of those provisions to this case, we believe it is important to set those provisions in their proper context. Accordingly, we will first discuss interest suspension in the context of amended returns generally. Then we will explain why the pertinent language from subdivision (f) and FTB Notice 2005-4 prohibit interest suspension with regard to the additional tax reported on appellants' amended VCI return.

1. *Interest Suspension on Amended Returns, Generally*

Notwithstanding appellants' arguments to the contrary, the plain language of section 19116 does not require interest suspension with respect to the additional tax reported on an amended return. Subdivision (a) of section 19116 sets forth the basic rule for interest suspension, stating in pertinent part:

> . . . if the Franchise Tax Board does not provide a notice to the taxpayer specifically stating the taxpayer's liability and the basis of the liability before the close of the notification period, the Franchise Tax Board shall suspend the imposition of any interest . . . which is properly allocable to the suspension period.

Subdivision (b)(2) then defines the "suspension period" as:

> . . . the period beginning on the day after the close of the notification period and ending on the date which is 15 days after the date on which notice described in subdivision (a) is provided by the Franchise Tax Board.

By defining the suspension period specifically by reference to the date on which respondent mails a notice of liability to the taxpayer, the statute clearly contemplates interest suspension in cases where respondent eventually mails such a notice. The statute does not define any suspension period in the absence of a notice from respondent. Thus, section 19116 requires interest suspension only if and when respondent sends a notice of liability to the taxpayer sometime after the end of the notification period. Without such a notice, the plain language of section 19116 provides no basis for suspending interest for

any particular period.

Although section 19116 does not explicitly define the term "notice," it does require that a "notice" specifically state the taxpayer's liability and the basis therefor. (Rev. & Tax. Code, § 19116, subd. (a).) There are several situations in which respondent would not mail any such notice. As relevant here, respondent does not issue a notice, for purposes of section 19116, when the taxpayer reports additional tax on an amended return. (As the IRS pointed out in Revenue Ruling 2005-4, the amended return has rendered the notice unnecessary.) Therefore, when the taxpayer files an amended return that reports additional tax, section 19116 does not require interest suspension with regard to any of the additional tax reported thereon.

Appellants maintain otherwise. Focusing on subdivision (a), appellants argue that the only prerequisite to interest suspension is respondent's failure to send a notice to the taxpayer within the notification period. According to appellants, there is no relevance to whatever respondent does (or does not do) after the notification period is over. Respondent did not send a notice to appellants during the notification period (however it is defined), so appellants argue that they are entitled to interest suspension. Appellants' reasoning is flawed because they do not read subdivision (a) in conjunction with the rest of the statute. While they correctly point out that subdivision (a) requires the absence of a notice during the notification period, appellants fail to recognize that subdivision (b)(2) requires the presence of a notice at some later date. If respondent never issues a notice for purposes of section 19116, there is no "suspension period" and, consequently, no basis for interest suspension.[8]

Our interpretation of section 19116 (i.e., that it applies only when respondent issues a notice of additional liability) is consistent with how the IRS interpreted IRC section 6404(g) before it issued Revenue Ruling 2005-4. While appellants insist that Revenue Ruling 2005-4 merely clarified and restated the IRS's belief that section 6404(g) had always applied when the taxpayer files an amended return, the IRS itself has stated that Revenue Ruling 2005-4 marked a change in policy. Concurrent with Revenue Ruling 2005-4, the IRS issued Information Release 2005-3, which stated in

[8] Absent a notice, the definition of "suspension period" is nonsensical; the period has a beginning date but no ending date. An open-ended suspension period would allow an unscrupulous taxpayer to file an amended return that discloses additional tax, but not actually pay that tax, and then simply wait for respondent to send him a notice, all the while holding the money free of interest. We cannot accept that such a result was intended.

pertinent part:

> The Internal Revenue Service today announced a liberalization of the rule for interest owed on additional taxes voluntarily reported by taxpayers.
>
> . . . [¶] . . .
>
> Previously, this rule was applied only where the additional taxes were found by the IRS. Today, Revenue Ruling 2005-4 extends the scope of section 6404(g) to additional taxes voluntarily reported by taxpayers on amended returns or in correspondence to the IRS.

In light of Information Release 2005-3, there is little doubt that the IRS originally interpreted section 6404(g) as applying only when the IRS mailed a notice of additional liability, and not when the taxpayer filed an amended return.

Our interpretation of section 19116 is also consistent with the widely accepted purpose of the interest suspension provisions, which is to ensure the taxpayer is not penalized for the taxing agency's failure to notify the taxpayer of an additional liability in a reasonable timeframe. It is not clear how that purpose would be served by suspending interest on the tax reported on an amended return, since a taxpayer who files an amended return must already know of the tax liability. The U.S. Congress apparently agreed, as it overruled Revenue Ruling 2005-4 less than a year after the ruling was issued.

Just as Revenue Ruling 2005-4 marked a change in federal policy, FTB Notice 2005-4 marked a change in California policy by allowing interest suspension when a taxpayer files an amended return.[9] On its face, FTB Notice 2005-4 is apparently inconsistent with the plain language of the statute; FTB Notice 2005-4 defines the period of interest suspension by reference to the date of an amended return while section 19116 defines that period by reference to the date of respondent's notice to the taxpayer. As appellants themselves point out, an amended return cannot be construed as a "notice" from respondent to the taxpayer. However, the two can be reconciled if the amended return is *treated as a notice* for purposes of administering the statute. Treating the amended return as a notice results in a suspension of interest from the end of the notification period through 15 days after the filing of an amended return, which is the result proposed in FTB Notice 2005-4.

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[9] Respondent has stated that, prior to FTB Notice 2005-4, it interpreted section 19116 as applying only when respondent sends a notice to the taxpayer. Appellant has not explicitly disputed that point and provides no evidence to rebut respondent's assertion.

2. *Interest Suspension on Amended Returns in Abusive Tax Shelter Cases*

Having discussed the application of section 19116 in the context of amended returns generally, we now turn to the specific provisions at the heart of this issue. Subdivision (f) of section 19116 states:

> For notices sent after January 1, 2004, this section does not apply to taxpayers with taxable income greater than two hundred thousand dollars ($200,000) that have been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter [within the meaning of the VCI].

As discussed earlier, FTB Notice 2005-4 implicitly treats an amended return as a "notice" for purposes of section 19116. Treating the amended return as a notice extends the benefits of interest suspension to taxpayers who come forward and voluntarily report additional tax. In order to give effect to the entire statute and remain logically consistent, FTB Notice 2005-4 also had to implicitly treat the amended return as a notice for purposes of subdivision (f). Accordingly, FTB Notice 2005-4 implements subdivision (f) in the context of amended returns by stating:

> Interest suspension does not apply to an amended return filed by a taxpayer on or after January 1, 2004, reporting additional tax as the result of the use of a potentially abusive tax shelter where the taxpayer was contacted by FTB about the use of a potentially abusive tax shelter and the taxpayer has taxable income greater than $200,000.

Appellants filed their amended VCI return after January 1, 2004, they had a taxable income greater than $200,000, and they were contacted by respondent about the use of a potentially abusive tax shelter. Therefore, subdivision (f), as implemented by FTB Notice 2005-4, bars interest suspension in this case.

Appellants object to the application of subdivision (f) in their situation. They begin by emphasizing that the plain language of subdivision (f) applies only when there is a "notice." Appellants then emphasize that a "notice" under section 19116 is something sent from respondent to the taxpayer that specifically states the taxpayer's liability and the basis therefor. Next, they point out that respondent has issued no such notice to them. Finally, appellants maintain that their amended VCI return is not, and cannot be treated as, a notice for purposes of section 19116. Appellants therefore argue that subdivision (f) does not apply in this case. Appellants further contend that, by treating an amended return as a "notice" for purposes of subdivision (f), FTB Notice 2005-4 is contrary to the plain language of the statute and should not be followed.

While we see the logic in appellants' objection to subdivision (f), there are additional consequences to that logic that undermine appellants' case. In particular, appellants fail to recognize that the plain language of subdivision (b)(2), which defines the "suspension period," also applies only when respondent issues a notice of additional liability to the taxpayer. If an amended return is neither a notice nor treated as a notice, then section 19116 does not require interest suspension with regard to the additional tax reported on an amended return. (See our detailed discussion of this point, *supra*.) Under appellants' argument, subdivision (f) would not apply, although not for the reason appellants believe; subdivision (f) would not prohibit interest suspension because section 19116 would not have suspended interest in the first place.

By attempting to define the "suspension period" by reference to the date of their amended VCI return, appellants implicitly treat their amended VCI return as a "notice" for purposes of subdivision (b)(2), yet they insist that their amended VCI return is not a "notice" for purposes of subdivision (f). Appellants cannot have it both ways. Either an amended return is treated as a "notice" for purposes of section 19116 or it is not. If an amended return is treated as a notice, interest suspension applies to amended returns generally, but subdivision (f) prohibits interest suspension with regard to appellants' amended VCI return. (See FTB Notice 2005-4.) If an amended return is not treated as a notice, then there is no "suspension period" and, consequently, no interest suspension. (See Rev. & Tax. Code, § 19116, subd. (b)(2).)

Whether this Board must treat any amended return as a "notice" for purposes of section 19116 is open to question. We have stated that respondent's administrative actions are entitled to great weight and will be followed absent clear error, such as a conflict with a statute or regulation. (See *Appeal of Brooks, Jr. and Danielle Walker, et al.*, 97-SBE-008, Apr. 24, 1997; *Appeal of Roy and Phyllis Watts*, 97-SBE-011, May 8, 1997.) In this instance we believe reasonable minds can differ about whether FTB Notice 2005-4 correctly treats an amended return as a notice for purposes of section 19116. On the one hand, there does not appear to be any support in the plain language of section 19116 for such treatment. On the other hand, respondent followed the IRS's interpretation of a similar statute and the Legislature has not seen fit to overturn respondent's interpretation (as Congress did with Revenue Ruling 2005-4). Because it ultimately would not affect the outcome of this appeal, we express

no opinion on the validity or persuasive nature of FTB Notice 2005-4.

VI. Conclusion

Appellants filed their amended VCI return prior to the end of the "notification period," as that period is extended by subdivision (e) of section 19116. Moreover, interest suspension does not apply to the additional tax reported on appellants' amended VCI return pursuant to subdivision (f) of section 19116. For these reasons, we conclude that appellants are not entitled to interest suspension under section 19116. Respondent's denial of appellants' claim for refund is therefore sustained.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19333 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Paul L. Mickelsen and Patricia Mickelsen for a refund of paid interest in the amount of $537,178 for the income year 1999 be and the same is hereby sustained.

Done at Sacramento, California, this 12th day of December, 2007, by the State Board of Equalization, with Board Members Ms. Yee, Ms. Chu, Mr. Leonard, Ms. Steel and Ms. Mandel present.

Betty T. Yee, Chair

Judy Chu, Ph.D., Member

Bill Leonard, Member

_____, Member

Marcy Jo Mandel*, Member

*For John Chiang per Government Code section 7.9.

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